The Farm Security and Rural Investment Act of 2002

by Kevin C. Condon and William E. Penn

Introduction

The Farm Security and Rural Investment Act of 2002 (FSRI), which governs federal farm programs for the next six years, was signed into law on May 13, 2002.[1] The FSRI is the first major update of farm programs by Congress since it passed the Federal Agriculture Improvement and Reform (FAIR) Act of 1996. What is the significance of understanding the FSRI? As with many federal statutes and programs, navigating the farm subsidy program eligibility requirements and regulations can be as difficult as canoeing through quicksand. When violations occur, the results can be costly for the farmer, with sanctions ranging from loss of payments to cancellation of contracts to criminal charges. Therefore, it is more important than ever that attorneys who represent the producers receiving subsidies understand FSRI. The only way to adequately represent your farmer clients is to immerse yourself in the highly technical aspects of the act. This article is only the tip of the iceberg and is intended to alert you to some of the bill's provisions. The article first summarizes certain farm subsidy payment programs, namely direct payments, counter-cyclical payments, marketing assistance loans, and loan deficiency payments, and the payment limitations that apply to those programs. It briefly discusses several other issues dealing with farm program payments.

Payment Programs

To receive payments on crops covered by the program, a producer enters into annual agreements for crop years 2002 to 2007. What type of payments will you encounter when you represent a producer?

Direct Payments

Under the 1996 legislation, producers who had "contract acres" received production flexibility contract (PFC) payments, also known as AMTA payments. Under FRSI, direct payments replace PFC payments.

Counter-Cyclical Payments

Counter-cyclical payments (CCPs) under FRSI replace the market loss assistance payments (MLAs) of the past. CCPs are designed to provide producers with a safety net when market prices of covered commodities drop below a certain level. Payments are based on historical production and are not tied to current production. The term *covered commodity* is defined as wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds.[2] For both direct payments and CCPs, the producer has to establish the base acres by electing one of two methods by which the base acres of all covered commodities of the farmer are to be determined. Under option one, the producer takes the sum of the four-year (1998–2001) average of acreage planted on the farm to covered commodities (including oilseeds) for harvest, grazing, haying, silage, or other similar purposes, and any acreage on the farm that the producers were prevented from planting during the 1998 through 2001 crop years to covered commodities because of drought, flood, or other natural disaster, or other conditions beyond the control of the producers, as determined by the Secretary of Agriculture. (herein referred to as "the Secretary").[3]

Under option two, use the sum of the following: contract acreage used to calculate the 2002 payment authorized by the 1996 act for the covered commodities on the farm plus the four-year average of eligible oilseed acreage on the farm.[4] Oilseed acres may not exceed the difference between the four-year average of planted and prevented planted acreage for all covered commodities and the total contracted under the 1996 act.[5]

If the producer fails to make the election or fails to notify the Secretary of the election made in a timely manner, as required, the producer is deemed to have made the election described in option two to determine base acres for all covered commodities on the farm.[6] The election made applies to all covered commodities on the farm.[7]

For the purpose of determining a four-year acreage average, the Secretary must not exclude any crop year in which a covered commodity was not planted.[8] In cases involving acreage that was prevented from being planted and was devoted to another commodity, the producer may elect the commodity to be used for that crop year in determining the four-year average.

As was the case under FAIR, the Secretary must provide for the establishment of a payment yield for each farm and for each covered commodity.[9] For direct payments, covered commodities, excluding oilseeds, will be treated the same as under the 1996 act if the yield was already established under that act.[10] If no yield has been established, the Secretary must establish an appropriate yield considering similar farms.[11] For oilseeds, the Secretary is to determine the actual yield for planted acres during the 1998 to 2001 crop year, excluding years in which oilseeds are not planted.[12]

For CCPs, if the producer retained the 1996 act's contract acres as base acres, the CCP yield is the same as the direct payment yield. If the producer elected to update base acres, the producer has a onetime opportunity to partially update the CCPs.[13] The selection is to be made at the same time as the selection of basic acres.[14] The act further directs the method of updating the yield.[15]

Calculation of Direct Payments and CCPs

In calculating direct payments, multiply the payment rate (in the act) by the payment acres times the payment yield.[16] The payment acres are 85 percent of the base acres. The payment rates used to make direct payments with respect to covered commodities for a crop year are as follows:

- wheat: $0.52 per bushel
- corn: $0.28 per bushel
- grain sorghum: $0.35 per bushel
- barley: $0.24 per bushel
- oats: $0.024 per bushel
- upland cotton: $0.0667 per pound
- rice: $2.35 per hundredweight
- soybeans: $0.44 per bushel
- other oilseeds: $0.0080 per pound [17]

CCPs are calculated by multiplying the payment rate by the payment acres times the payment yield (which may be different from the direct payment yield). The payment rate is determined by subtracting the effective price[18] from the target price. For purposes of the 2002 and 2003 crop years, the target prices for covered commodities are as follows:

- wheat: $3.86 per bushel
- corn: $2.60 per bushel
- grain sorghum: $2.54 per bushel
- barley: $2.21 per bushel
- oats: $1.40 per bushel
- upland cotton: $0.7240 per pound
- rice: $10.50 per hundredweight
- soybeans: $5.80 per bushel
- other oilseeds: $0.0980 per pound[19]

Timing of Payments

For the 2002 crop year, direct payments are to be made as soon as practicable after enactment.[20] In the case of each of the 2003 through 2007 crop years, payments are to be made on or after October 1 of the calendar year in which the crop of the covered commodity is harvested.[21] Producers may elect to receive an advance payment of up to 50 percent in any month beginning on December 1 of the calendar year before the calendar year in which the crop is harvested through the month within which the direct payment would otherwise be made.[22] If a producer on a farm that receives an advance direct payment for a crop year ceases to be a producer on that farm, or the extent to which the producer shares in the risk of producing a crop changes before the date the remainder of the direct payment is made, the producer is responsible for repaying the Secretary the applicable amount of the advance payment, as determined by the Secretary.[23]

Payments for CCPs should be made as soon as practicable after the end of the 12-month marketing year for the covered commodity. Sections 1103(2)–(4) govern the timing and amounts of advance payments for CCPs. Producers on a farm that receive partial payments for a crop year must repay the Secretary the amount, if any, by which the total of the partial payments exceeds the actual CCP to be made for the covered commodity for the crop year.[24]

Before a producer on a farm may receive direct payments or CCPs with respect to the farm, the producer must agree, during the crop year for which the payments are made and in exchange for the payments, to comply with certain conservation,[25] wetland,[26] and production flexibility requirements,[27] as well as several other agency requirements.

The production flexibility rules of the 1996 act are retained. Generally, any commodity or crop may be planted on base acres of a farm.[28] The prior prohibition on planting fruits and vegetables remains[29] with the additional prohibition of planting wild rice.[30]

Marketing Assistance Loans and Loan Deficiency Payments

Commodity loan programs allow producers of designated crops to receive a loan from

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the government at a commodity-specific loan rate per unit of production by pledging production as loan collateral. The Farm Service Agency (FSA) administers the commodity loan programs with marketing loan provisions for wheat, rice, corn, grain sorghum, barley, oats, upland cotton, soybeans, other oilseeds, peanuts, mohair, wool, honey, small chickpeas, lentils, and dry peas. After harvest, a farmer may obtain a loan for all or part of the new commodity production. The loan must have a term of nine months beginning on the first day of the first month after the month in which the loan is made.[31]

The loan may be repaid at the lesser of the loan rate plus interest, or at a rate determined by the Secretary that will minimize forfeitures and costs to the government.[32]

Loan deficiency payments (LDPs) are available if the producer agrees to forgo obtaining a commodity loan.[33] The LDP is computed as the product of the payment rate and the quantity not put under loan.[34] The payment rate is the amount by which the loan rate exceeds the loan repayment rate.[35] LDP rates will be determined on the date of request for the LDP.[36]

Although the complex formulas and detailed rules may seem daunting, it is important to realize that most of your clients will already understand the basics, so a grasp of the terminology used previously is important in gaining their respect.

Payment Limitations

Like the PFC payments under the 1996 legislation, direct payments are limited to $40,000 per person for covered commodities. The limitations on CCPs are $65,000 per person for covered commodities, and the payment limitations for marketing loan gains and LDPs are $75,000 per person.[37] Additionally, for the 2003 to 2007 crop years, an individual or entity will not be eligible to receive direct payments, CCPs, marketing loan gains, LDPs, or conservation payments (not discussed here) if the average adjusted gross income of the individual or entity exceeds $2.5 million, unless not less than 75 percent of the average adjusted gross income of the individual or entity is derived from farming, ranching, or forestry operations, as determined by the Secretary.[38]

The three-entity rule is retained. Under the three-entity rule, an individual can receive a full payment directly and up to a half payment from each of two additional entities. Although the complex formulas and detailed rules may seem daunting, it is important to realize that most of your clients will already understand the basics, so a grasp of the terminology used previously is important in gaining their respect. Most of our agricultural clients tell us that they need an attorney who "understands ag."

Other Commonly Occurring Issues

You will also need to understand some of the more common issues that lead to the need for an attorney when dealing with farm programs. Two are briefly discussed here:

Person Determination

Direct and counter-cyclical payments are subject to dollar limitations per "person." The analysis of whether a "person" exists is relatively easy. One need simply ask, is the purported "person" an individual or one of the listed business organizations? In other words, is the purported "person" organized as anything other than a joint operation? The more difficult issue is whether any "person" is combined with another "person." Is the individual or entity a "separate person" or part of a "combined person"? If two persons are combined, the combined person is limited to one payment limitation. For example, if two individuals are treated as separate persons, they are eligible to each receive $40,000 under a direct payment contract for a total of $80,000. If those same two individuals are combined as one person, those two individuals may only receive a total of $40,000 between them.

Various rules exist that cause persons to be combined and not treated as separate persons. These rules include (1) the combination of any owner of an entity (i.e., a business organization other than a general partnership or joint venture) with the entity itself when the owner holds more than 50 percent of the entity;[39] (2) the combination of two or more entities if more than 50 percent of those entities are owned by the same two or more individuals or entities;[40] (3) the combining of a sole income beneficiary of a trust with the trust;[41] (4) the combining of a revocable trust with its grantor;[42] (5) except for certain specific exceptions, the combining of husbands and wives;[43] and (6) except for certain specific exceptions, the combining of a minor with the minor's parent.[44]

A natural inquiry when determining whether a person exists and whether any persons are combined persons is to ask the following: at what time is the person determination made? In other words, if a corporation is formed on December 31 of a particular year, is that corporation treated as a person under the payment limitation regulations for that year? Or, if an individual who previously owned 70 percent of a corporation sells 40 percent of that corporation on June 1, is that individual treated as a separate person from the corporation in the year of the sale? That question is answered by the regulation at 7 CFR 1400.100, a section of the regulation that is aptly titled "Timing for Determining Status of Persons." That regulation provides the following:

> the status of an *individual or entity* on April 1 of the applicable program or fiscal year, shall be the basis on which determinations are made in accordance with this part. . . . Actions taken by an *individual or entity* after the applicable status date . . . shall not be used to determine whether there has been an increase in the number of persons for the applicable program or fiscal year (emphasis added).[45]

As a result, if a corporation is formed after April 1, a minor achieves majority after April 1, a husband and wife are divorced after April 1, or a majority stockholder sells 40 percent of the corporation after April 1, the act of the corporation being formed, the birthday celebration of the minor, the final judgment of divorce being granted, or the sale of 40 percent of the corporation must not be used to determine whether there has been an increase in the number of persons for that program. The status, as of April 1 of that year, is the "picture in time" used to make the person determination.

Actively Engaged in Farming

Another common issue is whether the farmer is actively engaged in farming. Before 1989, the limitation of federal farm program payments was done solely by determining whether persons were combined or separate. However, beginning in crop year 1989, in addition to limiting federal farm program payments through the use of person determinations, a threshold eligibility test was employed by requiring that each person be determined to be actively engaged in farming before that person was eligible to receive the first dollar in certain federal farm program payments.[46]

In general, to be "actively engaged in farming," a corporation, limited liability company, or similar entity must make a significant contribution to the farming operation of capital, land, or equipment. In addition, its stockholders or members who together own at least 50 percent of the entity must, collectively, make a significant contribution of active personal labor or active personal management.[47] When corporations or other similar entities are members of a joint operation (i.e., a joint venture or general partnership) that conducts the farming operation, the joint operation itself can make the "significant contribution" of capital, equipment, or land. Each entity partner whose members make a significant contribution of active personal labor or active personal management is considered "actively engaged in farming."[48] In addition, the total contributions made by or on behalf of each person must be at risk and must be commensurate with such person's share of the profits and losses from the farming operation.[49]

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When Legal Assistance is Needed

It is not uncommon for producers to run into legal difficulties as a result of a violation of one or more of the many regulations controlling farm program payments. Your assistance will usually be sought after there has been a determination from the FSA that a violation has occurred. You may be asked to represent the client at county and state committee hearings, in appealing the final agency determination through the U.S. Department of Agriculture (USDA) National Appeals Division, and if necessary, in Federal District Court. The first step is to understand the farm program payments. Further information can be found throughout the USDA's Web site at www.usda.gov/.

NOTES

1. The text of the bill, now PL 107-171, can be found at http://thomas.loc.gov/.
2. FSRI 1001(4).
3. FSRI 1101(a)(1)(A).
4. FSRI 1101(a)(1)(B).
5. FSRI 1101(a)(2).
6. FSRI 1101(c).
7. FSRI 1101(d).
8. FSRI 1101(a)(3).
9. FSRI 1102(a).
10. FSRI 1102(b).
11. FSRI 1102(c).
12. FSRI 1102(d).
13. FSRI 1102(e)(1).
14. FSRI 1102(e)(2).
15. FSRI 1102(e)(3).
16. FSRI 1103(c).
17. FSRI 1103(b).
18. The sum of the higher of national average marketing price during the marketing year or national average loan rate and the direct payment rate. FSRI 1104(b).
19. FSRI 1104(c)(1). For purposes of each of the 2004 through 2007 crop years, the target prices for covered commodities are as follows:

- wheat: $3.92 per bushel
- corn: $2.63 per bushel
- grain sorghum: $2.57 per bushel
- barley: $2.24 per bushel
- oats: $1.44 per bushel
- upland cotton: $0.7240 per pound
- rice: $10.50 per hundredweight

•soybeans: $5.80 per bushel
•other oilseeds: $0.1010 per pound. FSRI 1104(c)(2).
20. FSRI 1103(d)(1)(A).
21. FSRI 1103(d)(1)(B).
22. FSRI 1103(d)(2).
23. FSRI 1103(d)(3).
24. FSRI 1104(f)(5).
25. FSRI 1105(a)(1)(A).
26. FSRI 1105(a)(1)(B).
27. FSRI 1105(a)(1)(C).
28. FSRI 1106(a).
29. FSRI 1106(b)(3)(A), (B).
30. FSRI 1106(b)(3)(C).
31. FSRI 1203(a).
32. FSRI 1204(a). The loan rates for nonrecourse marketing assistance loans can be found at FSRI 1202.
33. FSRI 1205(a)(1).
34. FSRI 1205(b).
35. FSRI 1205(c).
36. FSRI 1205(e).
37. FSRI 1603(a).
38. FSRI 1604.
39. 7 CFR 1400.101(a).
40. 7 CFR 1400.101(b).
41. 7 CFR 1400.103(a).
42. 7 CFR 1400.103(c).
43. 7 CFR 1400.105.
44. 7 CFR 1400.106.
45. 7 CFR 1400.100.
46. *See generally* preamble to proposed rule, 53 Fed Reg 11,474 (April 6, 1988).
47. 7 USC 1308-1(b)(2)(B); 7 CFR 1400.201.
48. 7 USC 1308-1(b); 7 CFR 1400.201, 1400.203, and 1400.204.
49. 7 CFR 1400.201(d).

Kevin C. Condon is a partner at Condon and Wilcox, PC, a general practice firm in Eaton Rapids, with a focus on representing agricultural clients.

William E. Penn is the managing member of Agricultural and Rural Advocates, PLC, a firm in Williamston, focusing almost exclusively on agricultural law. Mr. Penn devotes approximately 90 percent of his time to representing clients with farm program payment issues. He has operated a large Michigan farm in the Saginaw Valley and served almost eight years as a senior U.S. Department of Agriculture official charged with administering federal farm programs. Condon and Wilcox, PC, and Agricultural and Rural Advocates, PLC, work closely with each other on many agricultural law issues, including farm program payments, zoning, and business organizations.